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Why is tourist activity recovering and prices still haven't?

It is crystal and clear that tourist activity has returned with force. However, many investors wonder why the prices of tourism companies continue to lag behind so much. Let's try to analyse what happens and the route that this situation may have:

a) The question of whether post-pandemic tourism was going to be like pre-pandemic tourism has already been resolved. No doubt.

There was a current of opinion, which we did not share, according to which post-pandemic tourism was going to be very different from pre-pandemic. In summary, they believed that tourist activity was going to be much lower in the future. This was not our opinion; **we have always defended that the tourist phenomenon was going to continue as soon as the possibility of traveling was restored.**

We have said it because **we have the actual reasons why people travel, which are around thirty**. They are, all of them, reasons that are very connected to the human nature, so that we did not doubt that people would turn to tourism as soon as they could. Let's take just one example of one of the reasons why people travel: the search for the sun. The need for sunlight is a primary human need. These psychological forces recurring tourist flows from places with little sunlight to places with high exposure to sunlight. Clearly, the end of the pandemic was not going to end this human need, nor the others.

b) The meteoric return of tourism. A reality.

According to data from STR (Smith Travel Research) and Jefferies, hotel reservations, in gross amount or Gross Booking Value (GBV), have exceeded in the third quarter of 2022 the pre-pandemic figures for the third quarter of 2019, which had been the historical highs. **Worldwide, the amount of hotel reservations was 3% higher than in the third quarter of 2019**. Both in the United States and in Europe, reservations were 9% higher than in 2019. In Europe, the breakdown by country reflects differences between them, thus in France or in Italy the bookings have been 20% higher than in 2019, while in Germany they have not grown. The impact of Asian countries has been noted, which still have important restrictions for Covid. Thus, in the Asia Pacific area, bookings have fallen -17% compared to 2019, while in the Middle East and Africa, they have been -1% compared to 2019. However, they have increased worldwide, as we have seen.

We also know, according to the same sources, **that the number of nights contracted worldwide has fallen by -7% compared to 2019, but that the price per room**

and night, the Average Daily Rate or ADR has increased by 11%, also compared to to 2019. Summarizing, tourists have spent more money, although they have stayed a little less in hotels, than in 2019. In the United States, prices have been 16% more expensive and in Europe 15% more expensive than 2019 Within Europe, France and Italy especially stand out, with price increases of more than 20%, and outside Europe, for example, Mexico stands out, with price increases of 39%.

c) Differences in Sales and EBITDA forecasts between 2021 and 2022.

Last year, the tourism sector already had forecasts for the recovery of activity in the future, both in terms of sales and EBITDA. What variations of these forecasts have there been in the year 2022, according to the consensus?

Aplicado Applied to the companies that make up the portfolio of the GVC Gaesco 300 Places Worldwide, FI fund, there have been the following changes:

I. The pre-pandemic sales recovery forecasts have advanced by 105 days, that is, a little more than three months in 2022 compared to 2021.

II. Pre-pandemic EBITDA recovery forecasts have been delayed by 51 days, that is, almost two months.

In other words, the recovery of sales has advanced and the recovery of EBITDA has been delayed. The quicker recovery of sales is totally consistent with the events that occurred in the demand side. What is the EBITDA delay based on instead? If we look company by company, we will see that we can group the causes into two main groups:

I. The persistence of Covid measures in Asia. Thus, in the United Kingdom, for instance, the restrictions due to Covid have already dropped from the level of 69.4 in the midst of the pandemic, in May 2020, to 11.1 on August 31, 2022, on a scale that goes from 0 (no restrictions) to 100 (total restrictions), according to the Oxford Covid-19 Government Stringency Index. In China, however, the restrictions have gone from 81.9 to 73.6 in the same time interval. In other words, the restrictions remain extremely high in China in particular and in the Asian zone in general. Thus, at the end of August, while in North America the number of aircraft flights was only -8% lower than in 2019, or in Europe, only -18%; China's international flights have fallen by -99%, those of Singapore by -45%, those of South Korea by -42% or those of Japan by -31%. Asia continues, to this day, with many restrictions still in place.

II. The rise in the oil price: It affects certain sectors where oil is an important part of the operating costs, such as cruise ships or airlines. The price of oil (Brent), which had ended 2021 at 77.8 dollars per barrel, is currently at 85.8 dollars per barrel, not far off, although it has had an average cost, so far of the year, of 102.5 dollars per barrel, sponsored by the Russo-Ukrainian war.

Interestingly, the estimate of higher oil costs for the coming years has affected both the companies that had it partially covered (Ryanair, etc.) and those that did not. Then the consensus has estimated a structural rise in the price of oil.

d) We consider the current situation as a great buying opportunity. Why?

Basically five reasons:

I. **The fundamental discounts at which companies in the sector are listed, were and are huge. They are among the largest that can currently be found in the markets.**

II. **The temporary delay of the EBITDA is so little that it does not force the decrease of the valuations.** Just two months of delay does not have a significant effect on valuations.

III. **The two factors that have forced the slight delay on EBITDA will soon disappear:**

a. **Covid restrictions in Asia have their days counting down.** On the other hand, the World Health Organization has recently declared that it will soon declare the official end of the pandemic. On the other side, we hope that the end of the pandemic in China will occur, at the earliest, in October, after the celebration of the 20th Congress of the Chinese Communist Party, in which the current president, Xi Jinping, is expected to be re-elected for a unprecedented third term. At the latest, we expect it by March 2023, once the Chinese New Year has passed, a period of great consumption, which could force China to prolong the restrictions in favour of internal consumption to the detriment of external consumption.

The day that China, the country in the world that spends the most on tourism outside its country, opens its borders, the market will soar, even more, considering that it will have been closed for almost three years. We equate this phenomenon to what happened when the first of the Covid vaccines was announced. Although it was public knowledge that several of them were going to be approved, the day the first one was announced and consequently the market had a big rise.

b. **The price of oil has already fallen sharply.** The price of oil has already normalized, after the initial impact of the Russian-Ukrainian war, and has entered within the ideal range of 80/90 dollars per barrel. At that level, world economic growth is not compromised, and the incentive for oil-producing countries is maximum. In fact, the producing countries could welcome any price above 65 dollars per barrel, the level at which most of them meet their public budget targets for changing the production model, which is their real goal.

c. Additionally, oil company margins in 2022 have been stratospheric. The average oil price for the year has come very close, without going over, to the price we believe would hurt global economic growth if exceeded, which is $107.8 per barrel. Thus, for example, Aramco, the largest oil company in the world, owned by the Kingdom of Saudi Arabia, is going to make a profit, in 2022, of some 164,000 million dollars. With this amount earned in a single year, he could buy Santander, BBVA, CaixaBank, Telefónica, Repsol and Aena in just one shot, and still have money left over. In economics, stratospheric margins are never lasting. The price of oil in the coming years will be significantly lower than in 2022. **The consensus will be forced to increase the EBITDA margins and the companies EBITDA in the tourism sector in the next updates.**

IV. Consumer appetite for services still intact.

Consumer appetite for services remains very high. The reason is that the Covid restrictions basically affected services, and not goods. In fact, the consumption of goods during the pandemic years was higher than its historical trend. **On the other hand, as far as services are concerned, the consumer accumulates a strong deficit. Half a year of relative normality in the West does not compensate the consumer for two years of pandemic.** Service consumption will also exceed its historical trend for some time. There is no recession in demand after a post-pandemic.

V. The consumer has economic possibilities to do so.

The strong tourist demand is an evidence. The comment has circulated through the media that this was so given that the consumer would be, supposedly, spending the extraordinary savings generated during the restrictions due to the virus. The data do not support this thesis. The money supply or M2, which includes banknotes and coins, current accounts and short-term bank deposits, is today 41.7% higher in the United States, compared to before the virus, and in the Euro Zone they are a 22.5% higher.

To put a closer, more specific case, according to data from the Bank of Spain, demand and term deposits of Spanish households amounted to 854,685 million euros in December 2019, and 960,485 million euros in December 2021. In other words, during the two years of the pandemic, Spanish families increased their liquidity by almost 106,000 million euros. Well, in July 2022, this figure had risen to 999,871 million euros. Summarizing, so far in 2022 they have increased their liquidity by almost 40,000 million euros more. **Consequently, although families are consuming very well, not only do they not reduce their savings, but they even increase them**. The main reason is low unemployment rates.

The Euro Zone has the lowest unemployment rate since its creation, 6.6%. In the United States, the unemployment rate is also in the historical low zone, but below 4%. Likewise, **the unemployment rate for the world's advanced economies stands at 4.7%, the lowest rate since 1980**. The reason why consumers continue to consume and save is because the labour market is very strong. Consumption depends, above all, on job expectations.

e) So, why are the prices of tourism companies lagging behind?

There are no objective reasons for it. Once certified and upon returning from tourism, its hypothetical risk premium has been normalized. **We enter into a matter of pure stock market dynamics. Anyone who knows the financial markets well knows that, at times, companies are listed both below what they are worth and above what they are worth. In what is a pendulum movement on prices around the fundamental valuation of companies.** Currently, whether due to the irreversible damage that interest rate hikes are having on investors in fixed income, due to the capitulations of the most neophyte investors in variable income, or due to the makeup effect or "window dressing" that some managers of funds use heading into the end of the quarter, tourism stocks, like all others, are under pressure.

The only ones who have reason to worry are investors who have invested in long duration fixed income, or those who have invested in long duration equities (growth companies). **The tourism sector is out of these problematic circumstances, constituting, today, one of the clearest investment opportunities that exist.**

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